TABLE 4. DIFFERENCES IN ASSUMPTIONS USED IN MODEL PROJECTIONS

	1987	1988	1989	1990	1991	1992
Performing Loans						
Most Likely (percent change from previous year)	a/	a/	0	5	5	5
Optimistic (percent change from previous year)	b/	0	5	5	5	5
Pessimistic (percent change from previous year)	c/	c/	0	2.5	5	5
New Nonaccrual Loans						
Most Likely (percent change from previous year)	-70	-25	-25	-25	0	0
Optimistic (percent change from previous year)	-75	-25	-25	-25	0	0
Pessimistic (percent change from previous year)	-65	-25	-25	-25	0	0
Gross Charge-offs						
Most Likely (percent of opening nonaccruals)	40	40	40	30	30	30
Optimistic (percent of opening nonaccruals)	40	40	30	30	30	30
Pessimistic (percent of opening nonaccruals)	40	50	40	40	30	30

SOURCE: Congressional Budget Office assumptions for an annual accounting model.

a. Decline at one-quarter the rate observed during the previous year.

b. Decline at one-eighth the rate observed during the previous year.

c. Decline at one-half the rate observed during the previous year.

The variables that have the greatest effect on the model's results are the level of performing loans and provisions for loan losses. In 1992, performing loan volume is projected to be nearly $8.0 billion less in the pessimistic case than in the most likely case. Because performing loan volume is down and because interest rates charged decline more rapidly in the pessimistic case, interest income also falls. For the years 1987 through 1992, the pessimistic case generates $4.1 billion less interest income than does the most likely case.

Interest expenses are also lower in the pessimistic case, since a lower level of debt is carried by the system. The decline in interest expense does not fully offset the decline in interest income, however, so net interest income for the six-year period is $1.6 billion less in the pessimistic case than in the most likely case.

There is some evidence to support the assumptions employed in the most likely case, at least for 1987. For example, performing loans

TABLE 5. SELECTED MEASURES OF PROJECTED FARM CREDIT SYSTEM FINANCIAL PERFORMANCE, ASSUMING NO LEGISLATIVE CHANGES (In billions of dollars)

	Scenario		
	Most Likely	Optimistic	Pessimistic
Cumulative Capital Shortfall (GAAP), 1987-1992	2.8	2.4	3.4
Volume of Performing Loans--1992	54.4	60.1	46.5
Volume of Nonaccrual Loans--1992	2.9	2.6	2.9
Loan Loss Reserve--1992	0.9	2.2	1.6
System Debt--1992	53.4	53.6	46.4
System Surplus--1992	6.6	7.4	5.6

SOURCE: Congressional Budget Office cost estimates.

fell by $3.5 billion during the first nine months of 1987 to stand at $47.6 billion, compared to a projected level of $47.8 billion at year-end in the most likely case. At the end of the third quarter of 1987, the FCS reported $6.0 billion in nonaccrual loans, versus $5.9 billion in the most likely scenario projection. The model's prediction of net interest income of $0.8 billion for 1987 is slightly more optimistic than the system's reported earnings of $0.4 billion over the first nine months of the year.

The significant differences between the results of the pessimistic and optimistic models should raise a number of cautions. First, it is difficult to predict accurately the future levels of the variables that are so important in determining the system's financial fate. Second, many of the factors that will influence these important variables are beyond the control of the FCS. For example, future provisions for loan losses will be determined by such factors as the rate of economic growth both here and abroad, exchange rates, the weather, and the quality of new loans made by the system. Only the last of these variables is under the control of the FCS. Another important variable, loan volume, will be affected by many of the same factors plus the competitiveness of the FCS relative to other agricultural lenders. To the extent that the system's competitiveness is eroded by requiring it to incur costs not borne by other lenders (for example, some of the borrowers' rights provisions discussed earlier), loan volume would be expected to fall and the cost of government assistance to rise. In short, the large change in needed assistance caused by relatively small differences in a few key variables indicates the fragility of the system's financial condition.

A different approach to determining the amount of federal assistance needed is to estimate the system's debt-servicing capacity, where debt-servicing capacity is defined as net income divided by the cost of debt. If an institution's debt-service capacity is less than its actual debt outstanding, it has more debt than it can service. One analysis examined the FLBs' debt-service capacity based on three projections of income and balance sheet figures in 1989.2/ This study found that the FLBs had between $2.1 billion and $4.7 billion of debt

2. See Charles Dodson and Bruce Bullock, "Estimates of Federal Land Bank Excess Debt," Working Paper 1987-16, Department of Agricultural Economics, University of Missouri, Columbia, Mo. (September 1987).

they could not service. The corresponding CBO estimate of assistance needed by the FLBs through 1989 ranges from $2.0 billion in the optimistic case to $2.5 billion in the pessimistic scenario.

The authors of the above-mentioned study conclude that "loans are not a solution to an excess debt problem of any borrower, including the Farm Credit System. A borrower with an excess debt problem already has more debt than can be repaid from expected income sources. Thus [an] equity capital injection or [an] assumption of the excess debt obligations by the government are the only meaningful solutions to the excess debt problem."3/ Given that some assistance for the FCS appears to be required, the next issue is how this aid might be tendered.

THE FORM OF FEDERAL ASSISTANCE

Federal assistance could be through direct capital transfers, government guarantees, or changes in the rules governing operating procedures.

Transfers of Capital

Capital infusions could take any of several forms. One option would be to provide the FCS with a loan (for example, through Department of the Treasury purchases of FCS bonds or lines of credit with the Treasury). The preceding section suggests that, if a loan is made, some form of subsidy or grant would have to be involved in order to solve the financial problems of the system.

A second form of direct transfer would be for the government to take over responsibility for servicing part of FCS debt. One means of doing this would be an interest-rate swap. An interest-rate swap is an arrangement between the Department of the Treasury and the FCS in which debt obligations are exchanged. For instance, the Treasury could agree to service some or all of the high-cost debt currently held by the FCS while the system would pay the interest expenses for the

3. Ibid, p. 11.

same amount of low-cost Treasury debt. In one analysis of a three-year interest-rate swap, the cost to the Treasury was $3.6 billion, and the system returned to profitability by the end of the swap.4/

Third, the government could transfer assets to the FCS as a means of bolstering the system's financial condition. The assets most commonly considered for such a transfer are those currently held by the Farmers Home Administration (FmHA) or the Commodity Credit Corporation (CCC). Either real assets, such as farmland and grain stocks, or financial assets, such as performing loans, might be considered for conveyance to the FCS. Transfer of the assets could be in the form of a gift or donation, or they could be sold to the FCS at a discount.

The transfer of real assets would have some drawbacks. Specifically, these assets would generally have to be sold to generate cash. Both commodity markets and land markets have been extremely weak in recent years, and the rapid disposal of large amounts of crops or acres could prolong this slump. To the extent that asset sales caused prices to fall, the FCS would be undermining its own financial condition. Falling land prices reduce the value of collateral backing FCS real estate loans, thereby exposing it to greater risk if the borrower becomes insolvent. If commodity prices were further depressed by sales of CCC stocks, this could reduce the ability of FCS borrowers to pay their debts. Transfers of financial assets would assist the system to the extent that they continued to perform according to terms and did not demand extraordinary amounts of servicing.

Federal Guarantees

The principal federal guarantee that might be considered is a more explicit guarantee of the interest and principal owed to bondholders. An explicit guarantee of FCS bonds would be expected to reduce the spread between Treasury bills and FCS bonds. However, since this spread is already relatively small (25 to 75 basis points in general) and would affect only additions to the system's debt, an explicit federal

4. David Freshwater, "Policy Options for Providing Financial Assistance to the Farm Credit System," paper presented at the NC-123 Conference, October 1986.

guarantee would have a modest impact on the system's financial condition.

Changes in Operating Procedures

Finally, rather than provide government transfers or more explicit guarantees on FCS bonds, changes in FCS operating procedures could be considered. One such change that has been discussed would be to create a special class of FCS bonds that would not have to be fully collateralized. When an FCS entity has insufficient assets to fully back all of its liabilities, it is said to have exhausted its collateral. Lack of collateral precludes the issuance of new debt. Moreover, when collateral is depleted, the ability of the district to meet its obligations to its bondholders is limited, thus triggering the joint and several liability clause. Relaxing or eliminating this requirement would allow a financially troubled district to sell additional bonds to meet obligations to bondholders and to redeem borrower stock. Such bonds would have to have a more formal governmental guarantee to make them salable. As discussed above, government guarantees generate potential future liabilities for the government. In addition, if, as the analysis of debt-service capacity indicated, the FCS already has more debt than it can service, this approach would simply increase the ultimate cost of dealing with the FCS's problems unless a more direct government subsidy was attached to the bond issues.

THE TIMING OF ASSISTANCE

In addition to the amount and form of assistance, an important variable in the success of federal assistance would be its timing. There are two competing interests in defining the point at which federal assistance is triggered. On the one hand, there is the desire that the system use as many of its own resources as is practical in dealing with its problems. After all, the FCS is supposed to be a private-sector lender and should be willing to accept the risks as well as the rewards of business. This implies that the FCS should first exhaust its own capital sources before federal assistance becomes available. Capital in the system is composed of earned surplus and equity purchased by borrowers, in the form of borrower stock and participation certificates.

One view is that both types of capital should be utilized in dealing with the FCS's problems. After all, if a private corporation is forced into bankruptcy, the capital contributed by stockholders is at risk, meaning that creditors must be satisfied before anything is paid to the stockholders. In this view, assistance should not be triggered until a bank has exhausted its capital and is precluded from participating in FCS bond issues. In fact the system has mobilized considerable amounts of capital in an attempt to deal with its financial problems. Several hundred million dollars have been transferred from stronger institutions to weaker ones in this attempt.

The other viewpoint suggests that delaying assistance too long would increase the final cost to the government. One example of this latter danger is the problem of borrower flight. FCS institutions are said to be owned by their borrowers. Ownership of these institutions is expressed through the purchase of borrower stock. Though the dimensions of the problem are unclear, many analysts assert that borrowers are fleeing the system because they feel their equity investment is at risk. Loss of these borrowers, who are said to be the most financially sound, reduces both the level of system capital and the volume of performing loans. Further, it is suggested that because the borrower stock purchase is not voluntary (it is a required part of obtaining a loan from the FCS) and because it has generally not been considered to be at risk, this source of capital should not be used to deal with the system's financial problems. This line of argument suggests that federal assistance should be triggered at the point when borrower stock is impaired.

MANAGING ASSISTANCE

Unless federal assistance is given to the FCS in one lump-sum payment, some sort of mechanism to manage disbursements to the system will have to be created. In defining the institution through which aid will flow, a trade-off exists between control on the one hand and flexibility on the other. Opting for greater control would allow oversight over how the money was spent and permit the government to have a greater impact on policymaking within the system (for example, various internal reforms could be preconditions for assistance). The advantage of a more flexible approach would be in encouraging local

input into decisionmaking. If a centralized, governmentally controlled entity was in charge of disbursing assistance, national standards might be applied to local problems. For example, there is a good deal of concern within the FCS about lending criteria. It would, however, be extremely difficult, if not impossible, to define a workable set of national guidelines for lending practices.

FEDERAL ASSISTANCE IN CURRENTLY PROPOSED LEGISLATION

Substantial differences exist between S. 1665 and H.R. 3030 with respect to the provision of assistance for the FCS. H.R. 3030 states that, subject to appropriations, such sums as may be necessary would be provided to the FCS. The amount the House would like to be authorized for 1988 is suggested by a floor amendment calling for the sale of $2.5 billion of FmHA assets. Assistance would be in the form of sale of stock to the Treasury. Repayment of funds borrowed from the Treasury would begin five years after the enactment of H.R. 3030 or one year after the insurance fund exceeded the secure base amount (as defined by the bill), whichever was sooner. Funds for repayment would come from an assessment on all banks of one-fifth of 1 percent of the average amount of accruing loans outstanding during the preceding year. The House bill would rescind authorization for the system to use the RAP system of accounting and would commence assistance when borrower stock was impaired on a GAAP basis. Assistance would be managed by a newly created institution called the Temporary Assistance Corporation (TAC). The TAC would have extensive powers, including the rights to approve a district's business plan (approval being a prerequisite to obtaining assistance), to purchase nonaccrual loans from system institutions, and to require FCS institutions to sell nonaccrual loans that have more than $500,000 in principal outstanding.

The Senate would authorize the creation of a new class of FCS bonds that would be issued without collateral. The system would be authorized to sell $4.0 billion of these special bonds. The government would guarantee the bonds but would exercise the guarantee only if system resources were insufficient to cover responsibilities to the holders of these special bonds. The government would provide annual

assistance equal to the amount of interest due on the bonds for the first five years and half the amount of interest due during the second five years. As currently written, the first $2.0 billion of this assistance would not have to be repaid. Substantively, this grant would be no different than the one implied by the House bill (no interest would be paid on funds acquired from the Treasury through the sale of stock, making it an interest-free loan). Assistance under the Senate bill would not be triggered until 25 percent of a bank's borrower stock had been depleted by losses (though all stock would be redeemed at par during the first five years). Assistance in S. 1665 would be managed by an institution called the Assistance Board (AB). The powers and responsibilities of the AB would be very similar to those of the TAC in H.R. 3030.

Implications of Proposed Legislation

Implications for the System. Both bills have opted for a relatively large degree of oversight regarding federal assistance, and give considerable power to the entities that would manage the flow of assistance (the TAC in the House bill and the AB in the Senate bill). As noted earlier, national management of a set of local problems might be inappropriate. Previous government assistance efforts such as those provided to Chrysler, Lockheed, and New York City were aimed at institutions that were much more homogeneous than the FCS and had more top-down management. This model may be inappropriate to the FCS, which makes loans in local markets under relatively diverse conditions.

Budgetary Implications. The most significant difference in the two approaches to funding FCS assistance is with respect to their budgetary treatment. Assistance provided under H.R. 3030 would be on-budget. The intent of S. 1665 is to move the bulk of the assistance off the budget. At issue is whether or not the value of uncollateralized bonds sold by the AB or some other entity should be counted as governmental expenditures (there is no question that payments made by the government that were tied to interest payments due would be treated as outlays). The argument for treating the bonds as a non-budgetary item is that these bonds would be issued by an entity within the FCS, and system entities would have equity invested in the institution. Since the FCS is a private-sector lender and none of the

other bonds sold by the FCS are treated as government outlays, neither should the new class of bonds be treated as such.

The opposite view is held by those who say that the government guarantee and the functional purpose (providing assistance rather than making income-generating loans) of the AB suggest that it would be truly a government entity and the bonds it issues should be treated as on-budget outlays. An alternative would be to treat the uncollateralized bonds in the same way guarantees have traditionally been treated, as a contingent liability for the government. Such contingent liabilities have been scored as outlays in the budget only when exercised. A detailed treatment of the policy and budgetary implications of the two bills is presented in the following chapter.

CHAPTER VI

A COMPARISON OF THE HOUSE AND SENATE BILLS

Three major issues must be addressed in any legislation dealing with the financial problems of the FCS: system restructuring, borrowers' rights, and the nature and extent of federal assistance. The House and Senate bills are often similar in their general approach to these three topics. However, significant differences exist in the details of the bills.

The House bill would more explicitly commit federal funds to resolving the financial problems of the FCS for the foreseeable future than would the Senate bill--but at higher cost. The House bill contains provisions requiring greater recapitalization (via capital reserves and an insurance program), and more comprehensive system restructuring, than does the Senate bill. Because the House bill would use federal funds to reestablish the capital position of the system, its cost would be relatively high. The House bill would make more policy-motivated changes in the structure and operation of the system (for example, more extensive borrowers' rights) than would the Senate bill.

The Senate bill is characterized by an effort to minimize its budgetary effects, principally by moving the bulk of the assistance package off the budget. Although this effort would dramatically reduce the budgetary impact of the Senate bill relative to the House proposal, it would still commit significant amounts of the country's resources to assisting the FCS.

FEDERAL ASSISTANCE IN THE HOUSE AND SENATE BILLS

This study estimates that, in the absence of legislation, the system's expected capital shortfall measured on a GAAP basis will be $2.8 billion through the year 1992. Allowing for the unforeseeable, a likely

range for the shortfall is $2.4 billion to $3.4 billion. This is the base from which the study analyzes legislative changes that would affect the profitability of the system. The budgetary impact of the House bill is relatively straightforward. Analysis of the Senate bill is more complex, since a distinction must be made between the bill's budgetary cost and its draw on the nation's capital markets.

Both the Senate and the House bills would, subject to appropriations, provide the system with sufficient assistance to enable it to regain its financial footing. The bills differ in the form of assistance and the point at which it would become available. Moreover, each bill provides for legislative changes affecting the system's capital position that would require additional funding. The House bill would increase federal spending by $6.2 billion through fiscal year 1992. In contrast, the Senate plan would only cost the government $0.8 billion over the first five years. The drain on capital markets, as represented by the borrowing that would result from the Senate bill, would be $3.1 billion. This section summarizes the component parts of the total cost estimates of the two bills.

Summary of H.R. 3030

The costs associated with the individual provisions of H.R. 3030 are summarized in Table 6. First, the House bill would reverse assessments made by the Farm Credit System Capital Corporation (Capital Corporation) and loss-sharing assessments made during the third quarter of 1986. The 1985 Farm Credit Act created the Capital Corporation and empowered it to assess financially healthy banks for funds needed to help weaker banks. This attempt at self-help has been the subject of a great deal of litigation, caused mainly by disagreements over the size of Capital Corporation assessments. The House bill would remove this source of controversy at a cost of approximately $800 million over the five-year period.

Second, H.R. 3030 would allow current borrowers to convert existing stock to a new, at-risk form of stock, or to reduce their indebtedness by the amount of their stock. It is unlikely that borrowers would benefit from converting to at-risk stock. Given the financial condition of the system, holders of at-risk stock could expect little in the way of patronage dividends; they would face a substantial risk of

not being able to redeem the stock at par after the first five years (during which it would be guaranteed by the government); and they would have to continue paying interest on the debt used in the purchase of the new stock. For these reasons, the study assumes that borrower stock would decline to negligible levels in 1988. The redemption of borrower stock would reduce FCS capital and (because borrower debt would be reduced by a like amount) diminish interest income in each subsequent year. Since borrower stock conversion would increase losses experienced by the system, an additional $500 million of federal assistance would be needed.

Borrowers' rights provisions would also increase the cost of H.R. 3030. The study assumes that FCS institutions are already restructuring loans if this is the least-cost alternative to dealing with financially stressed borrowers, so no additional costs would be generated by the restructuring portions of the borrowers' rights provisions. Likewise, the right of borrowers to see whatever is in their FCS

TABLE 6. SUMMARY OF ESTIMATED COSTS OF ASSISTING THE FARM CREDIT SYSTEM VIA H.R. 3030
(Total for fiscal years 1988-1992, in billions of dollars)

	Estimated Cost
Base Case--No Additional Legislative Requirements	2.8
With assessments reversed	3.6
With borrower stock dropped	4.1
With borrowers' rights	4.4
With system restructuring	4.3
With insurance	4.9
With minimum capital requirements	6.2

SOURCE: Congressional Budget Office cost estimates.

files would not generate additional costs. However, the study has concluded that other borrowers' rights, in particular the right of first refusal and the homestead provisions, would result in increased expenditures. The cost of these provisions through 1992 is estimated to be $360 million.

The House bill contains provisions for system restructuring. These include the authorization to merge unlike associations, the dissolution of district banks, and the formation of regional service centers. Because the structure of the FCS would be radically altered by these changes, it is difficult to predict their ultimate impact on the cost of the assistance package. The study assumes that some improvements in the operating efficiency of the system would result from reduced overhead at the association level and that some economies of scale would be achieved by going to six service centers. As a result, the estimated cost of H.R. 3030 falls by $100 million because of changes in the organization of the FCS.

H.R. 3030 would create an insurance system similar to the Federal Deposit Insurance Corporation covering commercial banks. Premiums would be based on the size and riskiness of the banks' portfolios. For institutions projected to be losing money, this additional expense would increase the cost of H.R. 3030 by the full amount of the premium. Banks at or near the break-even point would find that they needed federal assistance to make some or all of their insurance premium payments. The insurance program would cost the government an estimated $500 million during the next five years.

The House bill would require the FCA to establish minimum capital standards for FCS banks. The form and level of these minimum capital requirements are not specified but the bill calls for their gradual introduction over five years. The study assumes that these capital requirements would equal 5 percent of the FCS's average outstanding assets and would be phased in at 1 percent per year beginning in 1988. Like the insurance premium, the accumulation of this minimum capital would be a new expense. For banks that are currently in financial difficulty, federal payments would, in effect, fully fund the minimum capital requirement. Therefore, imposition of minimum capital requirements would increase the cost of H.R. 3030 by approximately $1.3 billion.

Finally, the House bill authorizes the creation of a secondary market for agricultural debt. As discussed earlier, a secondary market would not be able to offer competitive rates of interest and would therefore have limited impact on the FCS. Not only would the secondary market be unlikely to generate very much business, but the FCS would benefit from it to the extent that it was able to reduce its operating expenses (in proportion to any loss of business) and was paid fees for servicing the debt it sold to the secondary market. Since the secondary market would be somewhat apart from the FCS, it is not clear whether the system would receive any income generated by the secondary market. If the FCS did benefit from fees charged for credit enhancement, the secondary market could improve the financial standing of the FCS. In summary, this study found that the secondary market would neither increase nor decrease the cost of the FCS assistance package by more than $50 million through 1992.

Summary of S. 1665

Because the funding mechanism for S. 1665 differs so greatly from that of the House bill, the comparison of the two bills is not straightforward. The following discussion deals with the value of bonds that would be needed to cover losses, and the expected interest cost associated with those bonds. These costs are summarized in Table 7.

The Senate plan would provide federal assistance through a rather complicated process. First, an institution requiring assistance would apply to the Assistance Board for certification of need. Second, if certification was granted, the ailing lender would be allowed to issue preferred stock. Third, this stock would be sold to the Financial Assistance Corporation, which would raise the capital needed to purchase the stock by selling uncollateralized FCS bonds backed by a government guarantee. Finally, the government would provide direct assistance to the FCS based on the amount of interest due on the uncollateralized bonds. Based on a determination by the Office of Management and Budget, only the direct assistance (and not the value of the guaranteed bonds) would be scored as government outlays.

Again, before legislation, the base cost is $2.8 billion. The study assumes that the explicit federal guarantee allows the uncollateralized bonds to trade at rates 0.1 percent above Treasury bond

rates (a premium of 10 basis points). The CBO baseline projection for 15-year Treasury bonds was used to estimate the interest rate on the special FCS bonds.

The first legislative cost considered is the reversal of previous assessments. Unlike the House bill, the Senate would reverse only those assessments imposed by the Capital Corporation during the third quarter of 1986--a total of $122 million. Since some banks that are now in need of financial assistance would benefit from the reversal of these assessments, the total capital shortfall declines by about $50 million.

TABLE 7. SUMMARY OF ESTIMATED COSTS OF ASSISTING THE FARM CREDIT SYSTEM VIA S. 1665
(Total for fiscal years 1988-1992, in billions of dollars)

	Estimate	
	Bonds	Interest
Base Case--No Additional Legislative Requirements	2.8	n.a.
With capital corporation assessments reversed	2.7	n.a.
With capital assessment	2.7	n.a.
With preferred stock issued	2.6	0.735
With voting stock issued	2.7	0.760
With borrowers' rights	3.1	0.825
With system restructuring	3.0	0.815
With insurance	3.1	0.820

SOURCE: Congressional Budget Office cost estimates.

NOTE: The first column of figures represents the value of bonds that would have to be sold to meet the requirements imposed by S. 1665. The second column of numbers is an estimate of the total interest payments due on the bonds through fiscal year 1992. n.a. = not applicable.

The next consideration is the one-time assessment to provide money to purchase the preferred stock authorized by S. 1665. This money would be the first source of capital if an institution was unable to service its uncollateralized bonds. The study estimates that this assessment would generate approximately $250 million from the financially sound portions of the FCS. Since only those institutions that could pay without drawing their own capital stock below prescribed levels would be assessed, this provision would not affect the amount of assistance needed.

The FCS would be authorized by S. 1665 to sell preferred stock to the newly created Financial Assistance Corporation (FAC). The FAC would sell uncollateralized bonds to generate the capital to purchase the preferred stock. Authority to issue preferred stock would commence when borrower stock was reduced to 75 percent of its par value. Because a portion of borrower stock would be drawn down, the volume of bonds needed to be sold would be less than if the full capital shortfall had to be covered (as was the case in the House bill). The study estimates that selling uncollateralized bonds would generate $735 million in interest expenses (and therefore budgetary expenses) on bond sales of $2,600 million through 1992.

The Senate bill would require all borrowers to purchase voting stock in their institutions. This bill would also authorize the use of origination fees and allow the FCS greater discretion in defining the amount (if any) of borrower stock that would have to be purchased. This study assumed that the amount of borrower stock would trend downward over time as more borrowers opted for lower or no borrower stock purchases. Depleting borrower stock would increase interest expenses by $25 million and the amount of noncollateralized bonds issued by nearly $200 million.

The impact of borrowers' rights, system restructuring, and secondary market provisions would be similar to those of the House bill. Borrowers' rights would increase interest payments by $65 million and needed bond sales by nearly $350 million. System restructuring could reduce interest payments by $10 million and bond sales by more than $60 million. The secondary market should have a negligible impact on the cost of S. 1665.

Finally, the imposition of minimum capital requirements and an insurance program would have a much smaller impact on S. 1665 than the comparable programs in H.R. 3030. Since no penalties would be imposed on institutions that failed to meet minimum capital requirements, it was assumed that no additional bonds would be sold to attain them. The insurance program would not start assessing premiums until 1992, when approximately $90 million would be paid as premiums, resulting in an increase of $5 million in interest expenses and $30 million in bond sales.

CHANGES IN POLICY UNDER THE PROPOSED LEGISLATION

Both the House and the Senate bills have the potential to change the structure of the FCS dramatically. For example, the authority to merge different institutions within the system is similar in the two bills and would be expected to have similar consequences. Likewise, both would create a secondary mortgage market for agricultural loans that would probably have comparable results. They differ substantially, however, in the effects they would be likely to have on the FCS.

Probable Impacts of H.R. 3030 on the Farm Credit System

The House bill represents a comprehensive, though expensive, approach to the problems of the Farm Credit System as compared to the Senate bill. Since 1985, the earned surplus of the system has been almost completely depleted. Many institutions within the FCS are able to continue operations only because the Congress has authorized them to use the more liberal Regulatory Accounting Practices to postpone recognition of actual and expected losses. If the FCS is to survive, its capital stock must be replenished. By authorizing expenditures to rebuild the system's capital base, H.R. 3030 makes an explicit commitment to the future of the FCS.

The House bill would reconstitute the system's capital reserves directly through the general fund, and this is a major reason for the bill's relatively high budgetary cost. At least four provisions in H.R.

3030 pertain to rebuilding the capital stock of the FCS. First, the bill would permit farmer-borrowers to reduce their indebtedness by the amount of stock they hold in the system. This would reduce the capital of the system and the volume of its interest-earning assets. Further, this conversion would transfer all of the system's financial problems from the shoulders of the borrowers to those of the taxpayers.

Second, the House bill would allow all Capital Corporation assessments and loss-sharing contributions made during the third quarter of 1986 to be refunded to the institutions making the payments. The Capital Corporation assessments, in particular, were at the center of a controversy over the degree to which financially healthy districts should share in the misfortunes of other districts. To a certain extent, this substitution of public funds for FCS self-help could reduce the strength and meaning of the joint and several liability clause because it would substitute federal assistance for interdependence among parts of the system.

Third, the insurance program that would be established by the act can be seen as prepaid joint and several liability. Since some institutions would not be financially able to pay their insurance premiums during the next several years, taxpayers would be forced to pay for them. Establishing a workable insurance program should, in the long run, reduce the public's exposure to losses by the FCS but at a substantial short-term cost.

Finally, there is the issue of minimum capital requirements. As with the insurance program, there is much to recommend minimum capital requirements from a public policy point of view. If an FCS institution has a solid capital base, it is less likely to be imperiled by a short-term downturn in the agricultural economy. But, as with the insurance program, many institutions within the system would be unable to meet any minimum capital requirements without capital infusions from the government.

Given these efforts to rebuild the system's capital, it is not surprising that the FCS would be more financially sound at the end of five years under the House bill than under the Senate bill. As shown in Table 8, this study estimates total capital, excluding the preferred stock that would be issued under the Senate plan, as being $1.9 billion

greater under the House bill by 1992. If borrower-contributed capital is excluded, the difference in capital levels is even more pronounced ($3.5 billion more under H.R. 3030).

Does the system really need this much of a capital cushion? While there is no definitive answer to this question, relatively small changes in the assumptions used in the model result in pronounced increases in the estimated amount of assistance needed. This suggests that the financial condition of the system is still delicate. If a political judgment is made that the FCS deserves federal assistance, and if the Congress wants to place this issue behind it for the foreseeable future,

TABLE 8. A COMPARISON OF THE PROJECTED FINANCIAL CONDITION OF THE FCS UNDER H.R. 3030, AND UNDER S. 1665 (In billions of dollars)

	H.R. 3030	S. 1665
Cumulative GAAP Shortfall	6.2 a/	3.3
Cumulative Assistance	6.2	3.1 b/
Total Capital	6.2	4.3 c/
Total Earned Surplus	6.2	2.8
Insurance Reserve	0.4	0.1
Net Interest Income--1992	1.1	1.3

SOURCE: Congressional Budget Office cost estimates.

a. Includes minimum capital requirements.

b. Uncollateralized bond sales.

c. Excludes preferred stock.